No. 15,049

In the

United States Court of Appeals

For the Ninth Circuit

HONOLULU OIL CORPORATION,
a corporation,
Appellant,

vs.

KATHARINE H. KENNEDY and MARK C. ELWORTHY, Executors of the Will of Frank Kennedy, Deceased,
Appellees.

Appellees' Brief

Appeal from the District Court of the United States
for the Northern District of California,
Southern Division.

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SUBJECT INDEX

TEXTS

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On January 6, 1927, Frank Kennedy, then the owner of a U. S. Oil and Gas Prospecting Permit and fee land in the Kettleman Hills area, executed four documents with Kettleman Oil Corporation (appellant's predecessor) looking to the exploitation and development of Kennedy's properties. By these documents, upon which we later comment in more detail, Kennedy transferred to Kettleman Oil Corporation the greater portion of his interest in the permit and fee land, reserving for himself a percentage royalty interest or share "running with the land," and taking from Kettleman an operating agreement for the development of the lands and additional royalties on other properties.

The sole issue presented upon this appeal is whether, from such documents, the trial court was justified in finding that a fiduciary relationship existed between Kennedy and Kettleman Oil Corporation, so as to bar the running of the statute of limitations upon the collection, by Kennedy, of additional royalties concededly due him for the period commencing July 1, 1931, and ending August 29, 1935. It was stipulated between the parties that, if the statute of limitations did not run, appellees were entitled to such additional royalties in the amount of $9,519.11—and the trial court so held.

Appellant would apparently have the Court believe that, since the present action was not commenced until 1950, appellees were sleeping on their rights for fifteen years following the close of the period for which such additional royalties are owing. Such, however, is not the case. In 1940, Frank Kennedy and appellant's predecessor entered into a waiver (Exhibit BB to Statement of Agreed Facts), which tolled the statute of limitations until the final determination of the case of *United States of America v. General Petroleum Corporation of California, et al.*, 73 Fed. Supp. 225 (1946), then pending in the United States District Court. This action was not finally determined until October 16, 1950, when the trial court's decision was affirmed upon appeal to the Ninth Circuit, *sub nom Continental Oil Co. v. United States,* 184 Fed. 2d 802, (C.C.A. 9).

The present action was promptly filed upon the final determination of such case, and within the provisions of the waiver; and the agreed computation of additional royalties due appellees in this case was, concededly, based upon the decision in the *General Petroleum* case.

1. WHETHER A FIDUCIARY DUTY EXISTS BETWEEN THE PARTIES WAS A QUESTION OF FACT TO BE DETERMINED BY THE TRIAL COURT UPON THE STIPULATED EVIDENCE; AND THIS COURT SHOULD NOT DISTURB THE CONCLUSION OF THE TRIAL COURT UPON SUCH QUESTION OF FACT.

Whether or not a fiduciary duty exists between the parties is, as the case of *La Laguna Ranch Co. v. Dodge,* 18 Cal. 2d 132, 114 Pac. 2d 351 (1941), cited by appellant, shows, a question of fact to be determined from the documents defining the respective interests of the parties.

The documents defining appellees' interests here (i.e., the documents executed by Frank Kennedy and Kettleman Oil Corporation) have already been, as appellant's brief points out, three times construed by the United States District Court—and it has, each time, been determined that, upon the facts, it is clear that a fiduciary duty exists between the parties.

The first two of these determinations were made, as appellant's brief points out, in the case of *Kennedy v. Seaboard Oil Company,* (United States District Court, Northern District of California, Southern Division, Civil Action No. 22469-R), in which case the court was concerned with the construction of the same identical documents executed by Kennedy and the Kettleman Oil Corporation—since the Seaboard Oil Company, like appellant here, succeeded to a portion of the Kettleman Oil Corporation's interests.

In the *Seaboard* case, the question was first presented upon motion to dismiss, and Judge Harris, in a well reasoned decision, held that, upon the documents and facts themselves, a fiduciary relationship exists.

> *Kennedy v. Seaboard Oil Company,* 99 Fed. Supp. 730 (1951).

The *Seaboard* case later came to trial, upon cross motions for summary judgment and a Statement of Agreed Facts similar to that in this case, and Judge Goodman, in deciding in favor of appellees (Kennedy), held that he did so both for reasons of comity (with Judge Harris' decision) and:

> "* * * also because, *upon the evidence agreed to by the parties in the Statement of Agreed Fact*s and the matters admitted by the pleadings, I concur in the reasons given by him, I hold that the cause is not barred by the Statute of Limitations." (Order for Judgment, p. 2) (Emphasis ours.)

When, therefore, this case came to trial before Judge Carter, he had before him the decisions of Judge Harris and Judge Goodman, each holding that, upon the facts, the pertinent documents showed a fiduciary relationship so that the statute of limitations did not run. Judge Carter, accordingly, in making his decision in this case, on cross-motions for summary judgment and the Statement of Agreed Facts, stated that, for reasons of comity, he would similarly hold that the statute of limitations had not run. This was necessarily a square determination by Judge Carter of the single issue here involved—whether, as a matter of fact, the pertinent documents showed a fiduciary relationship between the parties.

It becomes readily apparent, therefore, that all the appellant seeks of this Court, and indeed all it could hope to achieve here, is a fourth determination upon the same essential facts. We submit that this case presents a most compelling situation in which to invoke the general rule that an appellate court will not disturb the findings of fact of the trial court—particularly where, as here, to find differently would be to find inconsistently with another final judgment upon the same essential facts.

2. THE DECISION OF THE TRIAL COURT IS AMPLY SUPPORTED BY THE FACTS TO WHICH THE PARTIES HAVE AGREED, AND BY THE APPLICABLE LAW.

But even were it not the general rule that this Court should recognize the determinations of fact by the trial court in this case, it is abundantly clear that the judgment of the trial court is amply supported, both in fact and in law.

It is true, as appellant has pointed out, that the relationship between the parties must be determined from the documents themselves, and not from anything extraneous to them. This does not mean, however, that, in the determination of the fiduciary relationship, appellant may look only to one document, out of the four documents, without relation to any of the others—for the intent of the parties is obviously to be determined by a consideration of all of the four documents, executed at the same time, together.

As we have noted, Exhibits A, B, C, and E to the Statement of Agreed Facts were executed on the same day, January 6, 1927, by Frank Kennedy and Kettleman Oil Corporation (appellant's predecessor). On this day, then, Frank Kennedy:

(1) conveyed to Kettleman Oil Corporation a quarter section of land in what is now known as the North Dome of the Kettleman Hills field, reserving to himself a certain percentage of the oil which should be produced from this land and a percentage of the proceeds of the sale of gasoline and oil which should be produced, manufactured, and sold from the land, *which reservation was specifically provided to be a "covenant running with the land,"* (Exhibit A);

(2) assigned to Kettleman Oil Corporation his interest in a U. S. Oil and Gas Prospecting Permit covering acreage in the Kettleman Hills oil field, reserving

therefrom royalty interests *which were also provided to be "covenants running with the land,"* (Exhibit B);

(3) received from Kettleman Oil Corporation a promise to pay to Kennedy additional royalties from certain lands in the same field in which Kennedy had no prior interest, (Exhibit C)—the amount of which royalties was increased by a supplementary agreement, (Exhibit D), dated December 6, 1928; and

(4) signed an operating agreement with Kettleman Oil Corporation providing for the exploitation by it of the lands included in the U. S. Oil and Gas Prospecting Permit owned by Kennedy (Exhibit E).

Although there are other conveyances and assignments included in the exhibits to the Statement of Agreed Facts, they relate, as appellant has stated, to mesne transactions whereby the rights and obligations created by the foregoing exhibits came to be held and assumed by the present parties; and do not include any lands in addition to those embraced in the four documents originally executed by Kennedy on the same day and from which the relationship between the parties is to be determined.

Looking at the four original documents together, the conclusion is inescapable that the parties entered into an integrated transaction, whereby Frank Kennedy, who owned land in fee and a prospecting permit in the Kettleman Hills area, deeded his land and assigned his permit to an oil company who had the capital to exploit them, receiving for them in exchange, royalty shares in all of the lands in which he so owned an interest; a promise to develop such lands for their mutual benefit; and other royalties from other lands.

a. The four original documents present an integrated plan for the development of the lands embraced therein.

The execution, on a single day, of the four original documents patently implemented an integrated transaction relating to the exploitation and development, for the joint benefit of the parties, of the lands embraced in such documents. Obviously, each of these four original documents was consideration for each of the other four original documents in this overall agreement—and one document may not be isolated for examination, as appellant seeks to do. It is clear, for example, that Kennedy would never have received royalty interests in other lands (Exhibit C) if he had not parted with interests in his lands and permit; and that Kettleman Oil Corporation would not have agreed to perform all of the operating and drilling requirements, permit obligations, etc.

Again, all of the lands covered by the four original documents were situated in a single known oil field, from which fact, in conjunction with the fact of the execution of such documents on a single day, it is evident that the parties intended the most efficient and productive development of all of said lands as a group rather than separately.

Still further evidence of the fact that the parties intended, by the four original documents, to create a single plan, is found in the fact that, in the various mesne conveyances which eventuated in appellant's ownership, the transfers of percentage interests always included both the fee lands and the leased lands obtained by virtue of the prospecting permit together—no severance of leased and fee lands being made.

The only logical conclusion which may be drawn from the foregoing facts is that a single integrated plan for the development of Kennedy's interests was entered into by the parties; and the trial court obviously so found. It necessarily follows, therefore, that whatever relationship was to be created by the parties applies equally to the entire group of properties and to each of the properties.

Significantly, appellant concedes a fiduciary relationship through a co-tenancy in the fee lands[1]—but seeks to evade the consequences of this concession by arguing that the fee lands must be considered apart from the relationship of the parties with relation to the prospecting permit lands. In view of the obvious integrated nature of the arrangement between Kennedy and Kettleman Oil Corporation, such was simply not the case. If, as appellant concedes, a fiduciary relationship existed between the parties as to part of the lands, then, obviously, it existed between the parties as to all of the lands, when the relationship of the parties as to all of the lands was embraced in the four original documents executed at the same time.

b. The practical facts also show that a fiduciary relationship was created as to each and all of the properties included in the arrangement.

Kennedy entered into his arrangement with Kettleman Oil Corporation because he was financially unable to develop and fructify his mineral resources himself.[2] For their joint benefit, therefore, he conveyed a part thereof to Kettleman Oil Corporation, which could exploit these resources, and he reserved to himself a portion as part of his consideration to have the other party so exploit them. Both financially and practically speaking, Kennedy was completely dependent upon the good faith and high ethical standards of his transferee, for he had neither the means nor the ability to deter-

1. Appellant's brief, p. 36.
2. Exhibit E to Statement of Agreed Facts.

mine the amount of oil to which he was entitled, or the fairness or accuracy of the price to be paid for his share of oil accruing under his agreements.

In good faith, Kennedy covenanted to continue to assist his transferee and its assigns toward their mutual goal by attempting to secure extensions in his name of the Government permit if Kettleman Oil Corporation should so desire; by attempting to secure a lease in his name should oil be discovered; and by assigning such lease to Kettleman Oil Corporation, or its assigns, upon request.

It was also provided that all of Kettleman Oil Corporation's promises and covenants, and all performance due Kennedy, should permanently bind Kettleman Oil Corporation, and its successors in interest, since it was obvious that Kennedy's interests were *covenants running with the land,* and thus imposed indefinitely into the future a fiduciary obligation to observe such covenants with relation to all the lands included in the agreements in which Kennedy had previously held an interest.

c. The prevailing law supports the obvious conclusion of the trial court that a cotenancy and trust relationship existed between the parties.

It is clear that, under the prevailing law, the judgment of the trial court is sound and is supported on each of several different bases.

1. IN CALIFORNIA AN OPERATING LESSEE IS A TRUSTEE FOR THE PAYMENT OF ASSIGNED ROYALTIES.

In *Taylor v. Odell,* 50 Cal. App. 2d 115, 122 Pac. 2d 919 (1942), the defendant Odell was owner of an oil lease which he assigned to an operating company, reserving a 20% royalty. The court held that Odell and the operating lessee were cotenants in a real property interest, with Odell owning a share of the oil. The actual conflict in that case was whether Odell stood in a fiduciary relationship to plaintiff, to whom he had assigned 0.5% of the oil to be produced under the lease in consideration of the grant of an easement to the operating lessee. The court found that plaintiff was an owner of oil along with Odell and the operating lessee, (i.e., a cotenant), and that, since the parties had followed the custom of Odell paying plaintiff royalty under this arrangement, Odell held plaintiff's oil or proceeds in trust, and was accountable to plaintiff accordingly. The court stated, p. 123:

> "* * * The moneys paid plaintiffs from the sales of the well's production was received as an incident to ownership, the same as rent from any real property. The assignment of the royalty interest in the well of the Two-and-One Oil Company vested in plaintiffs an interest in the oil produced by that company. When the money for production was received by Two-and-One, it was held in trust for plaintiffs if the company had knowledge of defendant's assignment. (Citing cases) * * *
>
> "As long as he held those moneys he was trustee for plaintiffs and was under obligation to account to plaintiffs for the moneys in his custody. Plaintiffs' action for an accounting and to enforce payment thereof is governed by section 343 Code of Civil Procedure; *Hannah v. Canty,* 175 Cal. 763, 768 (167 Pac. 373). The period of limitation began on the date of defendant's repudiation of his trust, April, 1935, less than four years prior to the filing of the action."

Odell's cotenancy relationship with the operating lessee in that case is the same as the Kennedy-Kettleman Oil Corporation relationship with respect to the leased lands, and plaintiff's relationship with Odell corresponds to the Kennedy-Kettleman Oil Corporation relationship as to the lands from which Kennedy received an override, but in which he had never owned an interest prior to 1927.

Again, in *Heaston & Glimpse v. West American Oil Co.*, 44 Cal. App. 2d 107, 111 Pac. 2d 905 (1941), the defendant oil company assigned a percentage of gross production under its operating lease to plaintiff, which assignment was to terminate when the consideration for the assignment, a loan from plaintiff to defendant, should have been fully repaid. Subsequently, the defendant ceased payment and asserted the statute of limitations as a bar to the plaintiff's suit on the ground that defendant had paid plaintiff royalties only on oil and not on the gas produced, and that, had the gas royalties been paid as they should have been, defendant's indebtedness to plaintiff would have been fully repaid more than four years prior to the commencement of plaintiff's action. The court held that defendant was obligated, as trustee, to pay the plaintiff out of production according to the terms of the assignment. The court observed that the parties agreed that the contractual relationship which they bore to each other was that of principal and agent. It seems clear however, from the facts of the case, that the only reason they thought of themselves as having this relationship was because the defendant lessee had the obligation of paying over to the plaintiff the royalties due him—which was identical with Kettleman Oil Corporation's (appellant's) obligation to Kennedy. The case stands as authority that in California an operating lessee will be held as trustee for the payment of assigned royalties; and, in this respect, the court said (p. 111):

> "* * * In the present case we are satisfied that the agreement constitutes the West American Oil Company a trustee of the funds derived from the sale of the oil and *gas* and respondent was entitled to rely upon the belief that its trustee was faithfully performing its

services under the contract until the contrary appeared. We believe that the assignment and the acceptance of it constituted an express trust and that the statute of limitations did not commence to run until respondent had knowledge of the repudiation of its terms and a violation thereof by the trustee. This doctrine is set forth in the case of *Allsopp v. Joshua Hendy Mach. Wks.,* 5 Cal. App. 228 (90 Pac. 39), where the court said (p. 234):

'But again, there was an express trust created by the transaction between the parties, and the statute of limitations would not begin to run until there was brought home to plaintiff knowledge of the repudiation of the trust or the violation of its terms on the part of defendant * * * The position of the agent is that of a trustee, and claims against him are governed by a rule similar to that controlling trustees.'

"In the case of *San Pedro Lumber Co. v. Reynolds,* 121 Cal. 74 (53 Pac. 410), the court said, at page 91:

'The statute of limitations cannot be successfully invoked. Reynolds was acting in a fiduciary capacity. Such of his acts as resulted in loss to the corporation were concealed breaches of trust. The statute of limitations would not begin to run in his favor, so as to enable him to escape the results of an accounting, until after knowledge by his principal of his derelictions. In this case the accounting was promptly demanded after discovery.' "

The following language from *Differding v. Ballagh,* 121 Cal. App. 1, 8 Pac. 2d 201 (1932), may be applied with equal force to the relationship between Kennedy and Kettleman (appellant):

"Their chances for 'returns' upon their 'investments', assuming that oil existed as was later proven, depended entirely upon the skill, industry, intelligence, honesty, and integrity of the trustees. The trustees had the money and independent power in the manner of its expenditure in drilling the two oil-wells. The production owners were given no rights by their contracts to even advise on these matters. If these facts did not create a condition in which the elements of trust and confidence between two groups must have existed, it would be hard to imagine one that did." (p. 6)

2. INDEPENDENTLY, A FIDUCIARY RELATIONSHIP EXISTS BECAUSE KENNEDY'S SHARE AND INTEREST ARE SPECIFICALLY PROVIDED TO BE "COVENANTS RUNNING WITH THE LAND."

The significant thing about the four original documents in this case—and the thing which appellant seeks to ignore—is the fact that the share and interests reserved by Frank Kennedy were, in each instance, declared to be *"covenants running with the land"* (Exhibits A and B). It is clear that, under prevailing law, the effect of this provision is to create a fiduciary relationship in perpetuity between the parties, and, for this independent reason, a fiducial relationship exists betwen the parties, so that the statute of limitations cannot run.

> *McClure v. Colyear,* 80 Cal. 378, 380; 22 Pac. 175 (1889);
>
> *Heaston & Glimpse v. West American Oil Co., supra,* p. 111;
>
> *Berniker v. Berniker,* 30 Cal. 2d 439, 448; 182 Pac. 2d 557 (1947).

In its discussion of fiduciary relationship, appellant's brief cites many cases for the proposition that, "The reservation of an overriding royalty, the execution of an oil and gas lease, or the assignment thereof does not *in and of itself* create any joint adventure, cotenancy, or any sort of fiduciary relationship between the parties."[1] Almost all of

1. Appellant's brief, p. 44. Emphasis ours.

these cases concern the termination of a lessee's royalty interest at the expiration of the leasehold term by an assignee who secures a renewal lease without preserving his assignor's royalty. That there is no fiduciary relationship in this circumstance—involving what counsel for appellant denominates the "usual, ordinary, everyday assignments, leases, and operating agreements"—is the general state of the law on this point.

But the very question before each of the trial courts, and again now before this Court, is precisely whether the pertinent documents in the case, taken individually and collectively, constitute "usual, everyday" assignments and conveyances, or whether they contain *something more* which imports a fiduciary relationship between the parties. For the law is different where the lease or assignment is subject to a *covenant running with the land,* or includes by its terms all extensions, modifications, and renewals thereof.

In the case of *Robinson v. Eagle-Picher Lead Co.,* 132 Kan. 860, 297 Pac. 697 (1931), cited at page 45 of appellant's brief, and in *Hawkins v. Klein,* 124 Okl. 161, 225 Pac. 570 (1926), lessee sued his assignee for cutting off his royalty where the assignee had taken a new lease in his own name at the expiration of the old lease without providing for a continuation of the lessee's royalty. The holding of each court ruled that the assignee had no fiduciary obligation to secure any benefit for the lessee under the new lease. Both courts recognized that opposite conclusions would be reached if the assignment contained features of perpetuity, as are present in the *Kennedy* case. The court in the *Robinson* case approved the principle that the perpetuity aspect created a fiduciary relationship when it pointed out that the ruling of the *Hawkins* case was correct, and continued:

"Because the following clause was in the original lease a different conclusion was reached in another recent Oklahoma case under very similar circumstances: 'This reservation shall likewise apply as to all modifications, renewals of such lease or extensions that the assignee, his successors or assigns may secure.' *Probst v. Hughes,* 143 Okl. 11, 12, 286 P. 875, 876, 69 A.L.R. 929."

The distinction between the situation argued by appellant —where there is only an "ordinary" lease with a specific term—and that here presented—where there is specific language of perpetuity and a larger continued interest— is succinctly pointed out in *Summers on Oil and Gas,* Vol. 3, Sec. 554, page 320, as follows:

"While the right to overriding royalty, or a sum of money paid out of production of oil or gas, created in the assignment, does not survive the termination of the assigned lease, yet in a number of cases the assignor has claimed that the assignee, by permitting the lease to expire, or by surrender thereof, and the taking of a second lease from the lessor, has violated a relation of trust and confidence, and that the assignor should be entitled to such overriding royalty or money out of production under the renewal lease. The mere assignment of an oil and gas lease creates no such fiduciary relation. If it is created, it must be by the terms of the assignment. In a number of cases the courts have held that the provisions of the assignment did not create a fiduciary relation between the parties so that the assignor would be entitled to the payment of overriding royalties or other sums out of oil or gas produced under a second lease taken by the assignee. *But where the assignment of a lease expressly provided that the reservation of an overriding royalty should apply to extensions, renewals or modifications of the lease that the assignee or his successors might secure, it was held that such provision created a relation of trust and con-*

> *fidence between the assignor and his assignees* permitting the assignor to payment of the overriding royalty reserved in the assignment out of oil or gas produced under the second lease. A similar result was reached relative to an amount payable out of the oil produced as consideration for the assignment, where the assignment required that the assignee give the assignor notice before relinquishing the lease and on request to reassign to the assignor, and the assignee took a new lease, prior to the expiration of the first lease, without giving the required notice." (Emphasis ours.)

Significantly, appellant's brief quotes only the first portion of this statement, and ignores the reference to the law governing the situation here where the appellees' interest—since it is a *covenant running with the land*—applies to "extensions, renewals, or modifications of the lease," and, as a matter of fact, is in perpetuity.

Similarly, in the case of *Oldland v. Gray,* 179 Fed. 2d 409 (C.C.A. 10, 1950), the assignee of a permit to explore and develop Federal land was held to be in fiduciary relationship to his assignor where the assignee covenanted to perform all the obligations of the permit or any extensions or renewals thereof. Though declining to pin a legal label on the relation, the court described it as "fiducial" and held that it bound remote sub-assignees to honor the plaintiff's royalty interests with respect to later leases secured from the Government, saying, p. 414:

> "Making application of this doctrine, it has been held that the assignment of an oil and gas lease reserving an overriding royalty, and providing that such reservation shall apply to all renewals, extensions and modifications, creates a trusteeship in the assignee, his successors and assigns for oil produced from a subsequent lease. *Probst v. Hughes,* 286 P. 875, 69 A.L.R. 929."

To the same effect, see *Howell v. Cooperative Refinery Assn.*, 176 Kan. 572, 271 Pac. 2d 271 (1954), *Kutz Canon Oil & Gas Co. v. Harr*, 56 N.M. 358, 244 Pac. 2d 522 (1952), and *Thornburgh v. Cole*, 201 Okl. 609, 207 Pac. 2d 1096 (1949).

Thus, where an overriding royalty owner's interest is a covenant running with the land or otherwise binds the successors in interest of the lessee-assignee, the underlying policy reasons preserving to the royalty owner, through the creation of a fiduciary relationship, his right to the continuation of his royalties in succeeding leases or assignments, extend also to preserving to that royalty owner his right to an accurate measurement or valuation and payment of that royalty interest. Where a royalty owner and/or his lessee-assignee insert into their written accord provisions for the making and receiving of performance *beyond the term of the lease*, they are thereby importing into that writing a fiduciary relationship relating not only to making and receiving performance, but to making and receiving it *in full* according to the terms relating to the measure of performance itself.

3. THE LA LAGUNA RANCH CASE, REFERRED TO BY APPELLANT, IS NOT INCONSISTENT WITH THIS WELL ESTABLISHED LAW. ON THE CONTRARY, IT ESTABLISHES THAT WHETHER OR NOT A COTENANCY RELATIONSHIP EXISTS IS A QUESTION OF "FACT" TO BE DETERMINED BY THE TRIAL COURT UPON THE EVIDENCE.

Commencing at page 36 of its brief, appellant belabors, at length, the contention that Kennedy, after the execution of the initial documents of transfer, had no *profit a prendre* to support a cotenancy in the "lease" lands, and, indeed, had no interest whatever in land sufficient to import a fiduciary relationship.

In attempted support of this argument, appellant quotes at length from the case of *La Laguna Ranch Co. v. Dodge*, 18 Cal. 2d 132, 114 Pac. 2d 351 (1941). Because this case and the two earlier cases of *Callahan v. Martin*, 3 Cal. 2d 110, 43 Pac. 2d 788 (1935) and *Payne v. Callahan*, 37 Cal. App. 2d 503, 99 Pac. 2d 1050 (1940), are of importance to the development of oil law in the State of California, and because the principles which they enunciate bear upon the case at bar, they are deserving of reference.

a. Callahan v. Martin.

In this case, the California Supreme Court had before it the question whether an oil royalty interest which had been assigned by the land owner from his reserved share survived a coveyance of the fee. Furthermore, as the court noted at page 114:

> "* * * the case involves the rights of an assignee of oil royalty under an assignment *unlimited as to duration*, not the rights of an assignee under an assignment limited to royalty to be realized from a designated lease." (The significance of the emphasis, which is ours, will appear presently.)

The court first set about to determine what the legal nature of a land owner's right to oil is. The court rejected the ruling followed in Texas and some other jurisdictions, that the land owner has an estate in the oil and gas in place beneath the surface, and concluded that the correct rule is that he has only the exclusive right to drill for oil and gas and to retain them when brought to the surface. The court next concluded that an operating lessee has an estate in real property, a *profit a prendre*. (Why the appellant attributes this latter determination to the later *La Laguna* case is not apparent.)

Considering next the status of the rights of the royalty owner's assignee, the court concluded that he, too, had an estate in real property, an incorporeal hereditament, and reviewed at some length the common law background of this type of interest in real property.

Because the assignee's rights to a share of the land owner's royalties were not limited to the duration of the lease, the court held that the assignee was a tenant in common with the land owner in his reserved right to enter and drill for oil, i.e., in his *profit a prendre*, at the expiration of the existing lease. From this holding it followed that the assignee's right could not be cut off by the land owner's conveyance of the fee to a third party.

b. Payne v. Callahan.

Callahan v. Martin left open the question of the rights of an assignee of a royalty interest from an operating lessee after a quitclaim by the lessee to his lessor. The District Court of Appeal considered this question in the *Payne* case. The court observed, most significantly, that unlike *Callahan v. Martin*, the assignments in the *Payne* case were limited *to the term of the then existing lease*. Despite this distinction, the court concluded that the analogy to the earlier case was such that it should hold that the assignee of the lease received, by his assignment, a portion of the lessee's *profit a prendre*. The assignee was, therefore, a tenant in common with the lessee, and his rights could not be defeated by the lessee's quitclaim to the lessor.

c. La Laguna Ranch Co. v. Dodge.

In 1941 the California Supreme Court (which, it will be recalled, had decided *Callahan v. Martin*), had before it a fact situation which presented the same problem as in the *Payne* case—i.e., an assignment limited to the term of the then existing lease. The court reviewed the principles which had been fixed by *Callahan*. It then observed that the lessor does not in every case intend to make his assignee a co-tenant in his exclusive right to drill for oil. With reference to the *Payne* case, the court stated (at page 138):

> "Thus, in so far as *Payne v. Callahan, supra,* holds that the fractional interests created either by the lessor or the operating lessee constitute a tenancy in common in a *profit a prendre as a matter of law,* it is expressly disapproved. In any case, the intention of the parties is controlling, and in the absence of a clear indication that such was the intent, the court will not construe royalty interests *created for the duration of a specific oil and gas lease* as granting the right to enter upon the land in question for the purpose of carrying on oil production or as creating a tenancy in common in the *profit a prendre* for that purpose." (Emphasis added.)

Since, under the facts before it in the *La Laguna* case, the royalty interests were created only for the duration of a specific lease, and nothing else indicated an intention that the assignee was to have the right of entry, the court affirmed the judgment quieting the land owner's title against the overriding royalty interest of the lessee's assignee.

A careful reading of these three cases makes apparent the point at which the District Court of Appeal in the *Payne* case deviated from the rules laid down by the Supreme Court in the *Callahan* case, ultimating in the disapproval expressed in the *La Laguna* case. The lower court went astray in failing to attach the significance which the Supreme Court had intended be given to the fact that, in the *Callahan* case, the assignee's royalty rights were not limited to the duration of the lease. Although the lower court remarked upon this difference, it in effect ran roughshod over it.

The important thing to observe about the *La Laguna* case, as the Supreme Court specifically noted, is that it involved an assignee's rights *which were limited by the duration of a specific lease*—and the court specifically recognized that, were the assignee's rights not so limited, a different situation would obtain; and further stated that whether such different situation obtained was a question of fact to be determined from the document itself. But in the *La Laguna* case the Supreme Court was in no way overruling its earlier holdings in the *Callahan* case. It simply made clear that the *Payne* case had not interpreted *Callahan* correctly, and it positively reaffirmed the *Callahan* holding that a cotenancy relationship was created where the assignee's royalty rights were—as they are here—in perpetuity.

As we have observed earlier in this brief, appellant has conceded[1] that Kennedy and Kettleman Oil Corporation were co-owners of the mineral estate in the fee land because the conveyance was by grant with reservation to Kennedy of a portion of the oil and gas estate. But, appellant adds, as to the lease lands, no cotenancy could have existed because Kennedy reserved to himself no portion of the oil and gas estate, the reason for this being that he granted to the operating company all his rights of entry and possession. This specious reasoning will not stand close analysis under the principles enunciated by the *Callahan* and *La Laguna* cases.

The assignment of the prospecting permit to Kettleman Oil Corporation included an exclusive right of entry. But to conclude from this that no interest remained which could support a cotenancy is to beg the question. By the rulings of

1. Opening Brief, p. 37.

the *Callahan* and *La Laguna* cases it is clear that a royalty owner with no right of entry still has an interest in real property, labeled an "incorporeal hereditament." Indeed, even in the limited situation presented in the *La Laguna* case, the Supreme Court held (page 140):

> "Defendants' overriding royalties were, therefore, interests in real property."

Therefore, when Kennedy reserved a royalty from his interest under the permit, he carved out a lesser interest under the permit. This lesser interest may be the subject of a cotenancy, and when Kennedy made this incorporeal hereditament a *covenant running with the land,* he unambiguously evidenced his intention that a cotenancy be created.

What of appellant's argument that the essential element of unity of possession is lacking? There are several answers to this question. In the first place, it is to be observed that the California courts have recognized that the incorporeal interests created in oil are not susceptible of being precisely conformed to the classic molds for incorporeal hereditaments and that their incidents must be redefined. Thus in *Callahan v. Martin, supra,* at page 126, the court observed:

> "Of course, it is not to be contemplated from the circumstance that tenants in common in oil rights have coequal rights of entry, that a large number of investors holding assignments of small percentages in oil rights will wish, each for himself, to undertake the production of oil. It is not necessary for us here to determine in detail the rights *inter se* of those who as tenants in common are jointly interested in oil rights in land. * * * If numerous holders of oil rights in a single parcel of land are unable to agree upon an operating lessee or upon the terms of an oil lease, we are inclined to think that the powers of a court of equity may be invoked to formulate a just and reasonable plan for the develop-

ment and production of oil upon the land, and to settle the controversy in accordance therewith. But this can be determined as the question may arise in future litigation. The rules of law should be sufficiently adaptable to reach a desirable result in this developing field of law."

In *Dabney-Johnston Oil Corp. v. Walden,* 4 Cal. 2d 637, 52 Pac. 2d 237 (1935), the court stated, at page 656:

"The rule permitting nonproducing cotenants to share in oil produced by a single cotenant is justified by the difference in a cotenancy in mineral rights and such a tenancy in the surface estate. This rule has become well established, as indicated in the annotations to which we have referred. The propriety of the principle was recognized by this court in the early case of *McCord v. Oakland Q. M. Co., supra,* where the court said, at page 148: 'But it may be conceded for the purposes of this decision, that the relation of the tenants in common, under the circumstances disclosed, is *sui generis,* and their rights peculiar. That while the extraction of ore from the mine by one tenant, who does not exclude his cotenants, is not waste, and the neglect of the latter to enter should be held an assent on their part to the exclusive occupation by the former; yet, because of the effect of the exclusive working by one may be to exhaust the mineral, and the uncertainty of the prospective value of the property may render it impossible to make a just partition of it, a court of equity should order an accounting; holding that while it must have been contemplated by the parties that the tenant in occupation should not be held for waste, nor prohibited from proceeding with his work by the cotenants who do not seek to enter, yet it must also have been contemplated that the tenant in occupation should not appropriate to himself the entire profits.' "

Again, in the *La Laguna* case itself, the court took note of this development:

> "This court has recently referred to the fact that the traditional categories of real property interests crystallized long before interests such as these found their way into the courts. (*Callahan v. Martin, supra*, p. 115.) The law relating to such oil rights has been said to be in a formative stage and the interests thus created have been considered *sui generis*. (*Dabney-Johnston Oil Corp. v. Walden, supra*, pp. 650, 651; *Schiffman v. Richfield Oil Co., supra*, p. 226.) Thus, although only a portion of the oil royalties here considered can actually be compared to rent in the traditional sense, the purpose and scope of all such royalty interests are so similar that all should be considered equally to be incorporeal interests in real property, subject to the same requirements and protected by the same safeguards." (p. 139)

It is clear then that, in the light of this developing law, the "exclusive possession" language in the assignment of the permit must be construed as constituting an arrangement between cotenants of the *profit a prendre,* giving Kettleman exclusive operating rights only as long as it fulfilled all of the terms of the assignment. In the event of a material breach of the agreement by the operating lessee, or its successors, Kennedy, having reserved his right as a covenant running with the land, could step in and exercise his right of possession.

But, whether or not the assignment imports a tenancy in common of the *profit,* it is plain that Kennedy and Kettleman were co-owners of a mineral estate of indefinite duration—and therefore cotenants—just as surely as they were in the case of the fee land. As to the latter, Kennedy's grant with reservation preserved to him an interest in the mineral estate of which he had been the full owner prior to the grant. As to the prospecting permit, Kennedy's assignment with reservation preserved to him an incorporeal interest in the real property which, whether or not it was a *profit*, was carved out of the *profit* assigned to Kettleman. Although Kettleman may have had a larger quantum of interest, if it was larger, it obviously included within its scope the same interest which Kennedy reserved, and they were co-owners and cotenants of this measure of incorporeal hereditament, whatever its label may be.

We have pointed out earlier in this brief that the admitted cotenancy relationship as to the fee land is sufficient, in this integrated transaction, to establish such a fiduciary relationship as to sustain the trial court's judgment. In addition to the foregoing, the cotenancy relationship between the parties as to the leased land becomes crystal-clear during the period for which the royalties in question were payable.

In reviewing the exhibits to the Statement of Agreed Facts, appellant comments, at page 29 of its brief, that it does not understand what pertinency Exhibit Y, the Kettleman North Dome Association Unit Agreement, has to any of the questions presented on this appeal. This document is pertinent for the following reason: It sets forth the rights and obligations of appellant's predecessor, with reference to the so-called Kennedy lease lands, as a member of the Kettleman North Dome Association during the period when the royalties in question were payable. Article II of the Kettleman North Dome Association Agreement provided that the members of the Association should transfer to it the exclusive possession for oil development purposes of the lands brought within the agreement, subject to a reservation as to non-participating lands.[1] Therefore, as to

1. Exhibit Y. Article II provides, in part, that Kettleman Oil Corporation (appellant) authorized the Association "* * * to take the exclusive possession of the lands described opposite its name as hereinafter subscribed for the purpose of development and opera-

Kettleman's participating lands or leases—which appellees agree are the only sources from which royalties are due them—Kettleman (appellant) assigned to the Association its *profit a prendre,* retaining the right to receive the oil produced, an incorporeal interest in real property of less quantum than a *profit a prendre*—so that, during the period here in question, the actual right of immediate possession was in neither the appellant nor appellees, but in the Association; and, as to the participating lands, appellant had no greater right than appellees, i.e., primarily the right to receive a share of the unit plan production. Thus, similarly as the unit plan operator stands in fiduciary relationship to both the royalty owners to whom it must pay royalties and to the lessee-assignee from which the unit operator obtained its operating rights (see *Young v. West Edmond Hunton Lime Unit,* 275 Pac. 2d 304 (Okl., 1954)), so also the assignee has fiduciary obligations to his assignor where he, and not the unit operator, is charged with the duty to pay the royalties due his assignor.

Looking at Kennedy's interest, after his assignment of the prospecting permit, in the light least favorable to him, he had at least *this same quantum of interest,* and since it was in the same lands and leases, there was an incontestable unity of possession and cotenancy during the very period when the royalties in question were earned.

The *La Laguna* case, therefore, is plainly not inconsistent with the District Court's decision in this case. It, at the

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tion of said lands for so long a period as oil or gas or other hydrocarbons shall be produced, or drilling operations shall be conducted by the Association on any of the lands included within this agreement.'' Frank Kennedy, as a royalty owner, had to give his consent to the inclusion in the Unit Plan of any lands in which he had an interest.

most, simply holds that, where an assignee's interest is limited to a specific document or term, the existence of a cotenancy is a question of fact to be determined from the documents themselves. *A fortiori,* therefore, where the documents creating the assignee's interest are "covenants running with the land" and running in perpetuity, it is clear that they create a cotenancy; and may even, under the holding of *Callahan v. Martin, supra,* create such a cotenancy as a matter of law. It is not necessary, however, to consider whether the *La Laguna* case, which applies solely to leases with a specified term, overrules the holding of the *Callahan* case—which applies to interests running in perpetuity. At the very least, the *La Laguna* case would hold such question to be a question of fact—and this question, as we have specified, has already been resolved by the trial court adversely to the appellant.

3. APPELLANT'S ASSUMPTIONS AND CONCLUSIONS TEND TO CONFUSE THE ISSUE, AND ARE NOT SUPPORTED BY LAW.

a. The existence of a fiduciary relationship must be determined from the operative facts in their actual context, and not from legalistic labels.

The fact that a fiduciary relationship existed between the parties is, as we have shown, to be determined by resort to the facts themselves—in this connection, primarily, the four original documents constituting the integrated statement of the relationship of the parties, one to the other. Appellant's brief, however, seeks to avoid this fact by the familiar device of holding up the definitions of several classic real property interests, and arguing that, since appellant conceives that this situation does not fall within those definitions, no fiduciary relationship exists.

The fallacies, however, of this Procrustean effort are self-evident—and it is well established that the traditional concepts of cotenancy and other forms of old English land tenure have long since yielded to developing conceptions—particularly with relation to the petroleum industry.[1] As the court states in *Dabney-Johnston Oil Corp. v. Walden, supra,* at page 650:

> "The failure of those who are dealing in oil rights to precisely describe the nature of the interests granted is due in part to the recent development of the oil industry. The law pertaining thereto is still in a formative stage. An analysis of the nature of oil interests which may be created involves an application of the common-law rules which crystallized before there were extensive dealings in subsurface fugacious substances. In the several jurisdictions in this country there is a contrariety of description as to the nature of these interests, and in a single jurisdiction, as in this state, there are conflicting expressions as to the description of oil interests. (See *Callahan v. Martin, supra.*) It is not surprising, in view of the lack of a definite terminology descriptive of these interests, that those who are dealing in oil interests have difficulty in describing the interest transferred, and that ambiguous and uncertain instruments are presented to the courts for analysis. Such instruments must be construed as a whole in the light of the circumstances under which they were executed and the expressed intent of the parties at that time. * * *"

Thus, when appellant, in its brief, devotes itself primarily to a citation of cases in which a "joint venture" was found not to exist upon particular facts, followed by a random

1. See the quotations from *Callahan v. Martin, Dabney-Johnston Oil Corp. v. Walden,* and *La Laguna Ranch Co. v. Dodge,* commencing *supra,* p. 22.

collection of disparate cases dealing in general with mineral leases, including those for oil and gas, in which the "ordinary, everyday oil and gas lease, assignment, or reservation of royalties" did not create a fiduciary relationship, it is simply attempting to misdirect the attention of the Court. All of such argument is predicated upon appellant's assumption that the documents here in evidence, and considered singly, created nothing more than an "ordinary oil and gas lease", which is, in fact, the very point in issue, and the point of fact upon which the trial court ruled adversely to appellant.

So, when appellant asks, "What is a fiduciary?" we observe that it is amply established that such term imports a notion of good faith and trust by one party in another, with a concomitant duty in the trusted party to observe high ethical standards, and to protect and insure the interests of the trusting party. One situation where the imposition of fiduciary obligations is appropriate is that in which one party, after rendering that part of his performance which is prerequisite to the second party's duty to commence counter-performance, must completely depend upon the second party's good faith in giving the full extent of the consideration promised, because the second party is in a superior or exclusive position in determining the amount of counter-performance. That, of course, is the situation here.

Kennedy transferred certain interests in real property, which was all the performance required of him, prerequisite to the transferee's obligation to develop the lands, and to pay, either in oil or in money, stated shares or royalties from these lands if oil were discovered; and Kennedy covenanted to render further performance at the request of his transferee to the end of preserving and perfecting its permit interest. As to these two parties, the measure of counter-performance due from Kettleman Oil Corporation (appellant) was in the latter's exclusive ability to determine. Kennedy had no means of determining the amount of royalties due under his integrated arrangement with Kettleman Oil Corporation at the outset, and much less after Kettleman Oil Corporation's interests were subdivided and assigned to various other oil companies, including appellant.

b. The form of the pleadings is not in issue.

Again, appellant is less than helpful when it inserts, in its brief, pages 48 to 51, an illusory issue regarding the form of complaint—for the form of the pleadings is not in issue. The sole question here is, as appellant concedes on pages 19 and 21 of its brief, whether a fiduciary relationship between the parties has been shown—and, if so, it is conceded that the judgment below is correct, and that appellant owes appellees the admitted sum of $9,519.11.

It is, of course, true that the averments in the complaint do not, of themselves, establish the fiduciary relationship between the parties, except in so far as appellant concedes the execution of the documents in question. However, these documents, and particularly the pertinent four original documents, have all been stipulated to by the parties; were evidence before the trial court; and were the basis of the trial court's determination on the pertinent facts involved.

c. Cases cited by appellant are not in point.

As we have already observed, most of the authorities cited by the appellant are concerned with situations where there was a specific lease only, with a specific term, or similar situation involved—but such is not the case here, where appellant's interest is an interest in perpetuity, and where, under the prevailing law, it is clear that appellant's interest is that of a cotenant.

Further, however, we note that appellant appears to rely heavily upon *Phillips Petroleum Co. v. Bynum,* 155 Fed. 2d 196 (C.C.A. 5, 1946). In that case the court, reluctantly declining to impose a fiduciary obligation on a lessee, follows the paragraph quoted in appellant's brief, page 46, with the significant remark:

> "But in view of the *Texas law* that the royalty owner has no title even to the one-eighth part of the gas, and that only the contractual relationship of debtor and creditor exists, we are unable to fasten the obligation to make a full disclosure where it really ought to be." (Emphasis ours.)

Similarly, appellant cites *Phillips Petroleum Co. v. Johnson,* 155 Fed. 2d 185 (C.C.A. 5, 1946). Both of these cases, however, involve the application of *Texas* law, which conceives that a royalty owner does not have title to a part of the oil or gas. This, however, is not the law in California where a royalty owner's right to proceeds is considered to be a right of ownership in the oil itself and, as such, an incorporeal interest in land.

Taylor v. Odell, supra;
Recovery Oil Co. v. Van Acker, 79 Cal. App. 2d 639, 180 Pac. 2d 436 (1947), and cases cited therein;
Callahan v. Martin, supra.

In California, then, more than a mere debtor-creditor relationship exists, and the courts can and will enforce the obligation of a lessee to deal in good faith on a fiduciary basis with royalty owners.

Taylor v. Odell, supra;
Heaston & Glimpse v. West American Oil Co., supra.

Similarly, the case of *MacDonald v. Follett,* 142 Tex. 616, 180 S.W. 2d 334 (1944), cited by appellant, should afford it little solace. That case involved an overriding royalty interest, which, by *oral agreement,* was owned jointly by plaintiff and defendant. Upon the expiration of the lease, defendant took a new lease in his name as before, but did not then convey a half interest to the plaintiff, as he had under the previous lease. In determining whether plaintiff was entitled to a half interest as beneficiary of a fiduciary relationship, the court stated that if they had, as part of their oral agreement, agreed to work together to obtain a renewal of the lease, they were cotenants. The court then remanded the case for a determination of that factual issue—and the trial court's subsequent finding of a fiduciary relationship was upheld on the second appeal. See *MacDonald v. Follett,* 193 S.W. (2d) 287 (1946).

The cases of *O'Donnell v. Snowden & McSweeney,* 318 Ill. 374, 149 N.E. 253 (1925); *Fowler v. Associated Oil Co.,* 74 Pac. 2d 727 (1937); *Gordon v. Empire Gas and Fuel Co.,* 63 Fed. 2d 487 (C.C.A. 5, 1933); *Henry v. Gulf Refining Co.,* 179 Ark. 138, 15 S.W. 2d 979 (1929), and *Shropshire v. Hammond,* 120 S.W. 2d 282 (Tex. Civ. App. 1938); also cited by appellant, like many of the other cases cited by it, relate to "ordinary, everyday" oil leases, with specific terms, so that they are not here apposite.

4. CONCLUSION.

The decision of the trial court in this case does not present a complete re-writing of existing law, or the making of every debtor a trustee for his creditor, as appellant so broadly asserts.

On the contrary, we are here concerned with the specific language of four original documents creating a relationship in perpetuity between two parties for the exploitation of oil properties for their mutual benefit. The decision in this case, therefore, is no broader than the specific language of the documents involved. When the trial court determined, as a question of fact, as it did, that such language was sufficient to create a fiduciary relationship between the parties, it did so, as we have shown, in response to well established law, and it was amply supported in its determination by the documents in evidence.

This same determination upon these precise documents has been made, not once, but, as we have shown, three successive times. We submit that there should be an end to the repeated re-arguing of this same contention; that there is no reason to disturb the decision of the trial court; that the appellees should have the sum of $9,519.11 concededly owing from appellant, and which is payable unless appellant can invoke its technical defense of the statute of limitations; and that the judgment of the District Court awarding appellees that amount should be affirmed.

Respectfully submitted,

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